87-941

Supreme Court, U.S.
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No.

in the Supreme Court of the United States

OCTOBER TERM, 1987

CITIBANK, N.A.,

Petitioner,

v.

DATA LEASE FINANCIAL CORPORATION, *et al.*,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

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QUESTIONS PRESENTED

1. Whether state law may impose the duty to manage a national bank upon persons beyond the bank's directors when the National Bank Act specifically invests the bank's board of directors with the ultimate responsibility for the management of a national bank.

2. Whether a pledgee of corporate stock, in possession of the stock certificates, may be held liable for a decline in the underlying value of the stock, absent proof that the pledgee acted with the specific intent to deplete the collateral's value.

PARTIES TO THE PROCEEDING

Petitioner is Citibank, N.A.

Respondents are Data Lease Financial Corporation, Edward Grafton, William Krusen, Andrew Machata, Robert Marlin, R. Dale Melching, MGIC Indemnity Corporation, Truman Skinner, and Joseph Stefan.

DESIGNATION OF CORPORATE RELATIONSHIPS

A list of all parent companies, subsidiaries (except wholly owned subsidiaries), and affiliates of Petitioner Citibank, N.A., and of each such corporation, is included in the Appendix which accompanies this Petition at A-102.[1]

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[1]References to Citibank's Appendix to Petition for a Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit, filed contemporaneously herewith, are cited herein as "A-____."

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

Petitioner, Citibank, N.A. ("Citibank"), requests that a writ of certiorari be issued to review the opinion and judgment of the United States Court of Appeals for the Eleventh Circuit.

OPINIONS BELOW

The opinion of the court of appeals is reported at 828 F.2d 686 (11th Cir. 1987) and is set out in the Appendix to this Petition at A-1. The orders of the district court granting summary judgment to Citibank were entered on January 8, 1986, and March 21, 1986, and are included in the Appendix at

A-35 and A-59, respectively. The United States Court of Appeals for the Fifth Circuit has rendered an opinion in this case, reported at 645 F.2d 333 (5th Cir. 1981); the opinion is not pertinent to this Petition.

JURISDICTION

The opinion of the court of appeals for which certiorari is sought was entered on September 28, 1987. 828 F.2d 686 (11th Cir. 1987). A-1. On November 3, 1987, the court of appeals denied the petition for rehearing and suggestion of rehearing *in banc* filed by Citibank. A-74.

This Court has jurisdiction to review the judgment of the court of appeals by writ of certiorari pursuant to 28 U.S.C.A. § 1254(1) (West 1966). The Petition is timely under 28 U.S.C.A. § 2101(c) (West 1982) and Rules 20.2 and 20.4 of this Court.

STATUTES INVOLVED

The National Bank Act provides in pertinent part as follows:

> *The affairs of each association shall be managed by . . . [its] directors. . . .*

12 U.S.C.A. § 71 (West Supp. 1987) (emphasis added).

> [A] national banking association . . . *shall have power —*
>
> *To exercise by its board of directors,* subject to law, all such incidental powers as shall be necessary to carry on the business of banking . . . .

12 U.S.C.A. § 24, Seventh (West Supp. 1987) (emphasis added).

STATEMENT OF THE CASE

Petitioner Citibank brought this action in 1978, in the Southern District of Florida, to foreclose upon 80.2% of the capital stock of Miami National Bank ("Miami National"). The stock was pledged by respondent, Data Lease Financial Corporation ("Data Lease"), to secure loans of $6.2 million made to it by Citibank in 1973. Data Lease defaulted on its obligations in July, 1974, and remained in default at all times thereafter.

Data Lease filed a counterclaim against Citibank and a third party complaint against former directors of Miami National alleging that the Miami National directors mismanaged Miami National, resulting in an overall decline in the underlying value of the Miami National stock. Data Lease contends that Citibank is vicariously liable for the actions of the Miami National directors.[2]

Data Lease's claims against Citibank are predicated upon certain changes in management at Miami National which occurred in 1975. The changes were precipitated by severe problems uncovered during examinations of Miami National by the federal regulators. In early 1975, national bank examiners expressed shock and alarm at Miami National's

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[2]The first three counts of Data Lease's counterclaim and third party complaint, directed against both Citibank and the Miami National directors, claim conversion (Count I), fraud (Count II), and negligence (Count III). Counts IV and V assert claims only against Citibank, based upon the Uniform Commercial Code.

financial condition and called into question the competence of Miami National's management. The examiners concluded that the future well-being of Miami National, under management elected by Data Lease, appeared questionable.

On May 16, 1975, five Miami National directors resigned from the board subsequent to the execution of a memorandum of understanding between Citibank and Data Lease. Eight other directors, all elected by Data Lease prior to May, 1975, remained on the board. The remaining board members selected third party defendants Joseph Stefan and Truman Skinner to fill vacant seats created by the resignations, and elected Joseph Stefan as president and chairman of the board.

Data Lease alleges that Citibank "took control" of Miami National by "installing its directors and officers" in May, 1975, and by re-electing those people in 1976, 1977, and 1978. Based upon such purported "control," Data Lease contends that Citibank can be held vicariously liable for any mismanagement by the directors of Miami National, and any resulting decline in the underlying value of the pledged Miami National stock.[3]

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[3]Beginning in 1976, Citibank exercised its right under the 1973 pledge agreement entered between Data Lease and Citibank to vote the Miami National stock it held as collateral. Only two of the third party defendant directors were Citibank nominees; the remaining five were Data Lease's designees. There was no relationship whatsoever between Citibank and the majority of the board of directors of Miami National, other than the fact that Citibank voted for them after their first having been installed on the Miami National board by Data Lease.

In early 1986, the district court entered several orders granting Citibank summary judgment on its complaint and on Data Lease's counterclaim. A-35, A-59. The district court correctly determined that the National Bank Act precluded Citibank from being held vicariously liable for the actions of the Miami National directors, when acting in their capacity as directors of Miami National. A-41-42,60. Additionally, the district court entered summary judgment because Data Lease failed to demonstrate that Citibank acted with the specific intent to depreciate the underlying value of the pledged Miami National stock. Relying on the opinion of the United States Court of Appeals for the Fifth Circuit in *Empire Life Insurance Co. of America v. Valdak Corp.*, 468 F.2d 330 (5th Cir. 1972), the district court determined that Data Lease could not support its claims under the Uniform Commercial Code ("U.C.C."). A-67.

On April 4, 1986, the district court entered its final judgment of foreclosure from which Data Lease appealed. A-71. The United States Court of Appeals for the Eleventh Circuit reversed the district court's summary judgment by its opinion rendered September 28, 1987. A-1. In so doing, the Eleventh Circuit ignored the plain language of the National Bank Act investing the power to manage Miami National only in the bank's board of directors. In the first decision of its kind, the Eleventh Circuit applied state law and ruled that persons beyond the bank's board of directors can bear ultimate legal responsibility for the management of a national bank. A-16. The opinion is in direct conflict with the National Bank Act.

Additionally, the Eleventh Circuit reversed the summary judgment entered in favor of Citibank on Data Lease's U.C.C. claims. The court of appeals

held that summary judgment on these claims was error, stating that there was evidence in the record tending to show that Citibank "install[ed] and maintain[ed] incompetent individuals in positions of management at Miami National" and that Citibank "blithely allowed [the Miami National directors] to deplete the value of the pledged collateral." A-28-29. The decision directly conflicts with the Fifth Circuit's opinion in *Empire Life* which requires Data Lease to demonstrate that Citibank acted with the *specific intent* to depreciate the underlying value of the Miami National stock.

Citibank petitioned the Eleventh Circuit for rehearing and filed a suggestion for rehearing *in banc*. A-76. On November 3, 1987, the petition and suggestion were denied. A-74.

REASONS FOR ALLOWING THE WRIT

I. THE ELEVENTH CIRCUIT'S DECISION CONFLICTS WITH THE NATIONAL BANK ACT.

The Eleventh Circuit's decision holds for the first time that a person beyond the director of a national bank can be ultimately responsible for the management of a national bank. Applying Florida agency law, which in this case directly conflicts with the National Bank Act, the court of appeals mistakenly concludes that a third party can be vicariously liable for director mismanagement of a national bank. The National Bank Act specifically provides that a national bank shall be managed by its directors. 12 U.S.C.A. §§ 24, 71 (West Supp. 1987) Thus, it is the bank's board of directors which bears ultimate responsibility for the bank's management, as a matter of federal law. It is the Act alone — and not state law — which directs who has the ultimate responsibility for the management of a national bank.

It is well settled that Congress alone has the authority to regulate and control national banks. *E.g., Easton v. Iowa,* 188 U.S. 220, 231-34 (1903). National banks are instruments of the federal government "designed to be used to aid the government in the administration of an important branch of the public service." *Farmers' & Mechanics' Nat'l Bank v. Dearing,* 91 U.S. 29, 33-34 (1875); *Van Reed v. People's Nat'l Bank,* 198 U.S. 554, 555 (1905); *Davis v. Elmira Sav. Bank,* 161 U.S. 275, 284-85 (1896). Congressional authority over national banks is paramount. *First Nat'l Bank v. Missouri,* 263 U.S. 640, 656 (1924).

State law may not conflict with the operation of a national bank and state law which infringes upon the functions of a national bank is void. *Davis,* 161 U.S. at 283. This Court has recognized that general state legal authority applicable to private corporations is often inapplicable to national banks because the latter are "created for public and national purposes." *See Easton,* 188 U.S. at 229. In *Davis,* this Court declared that:

> [A]n attempt by a state to define [national banks'] duties or control the conduct of their officers is void, wherever such attempted exercise of authority expressly conflicts with the laws of the United States, and either frustrates the purpose of the national legislation or impairs the efficiency of these agencies of the Federal government to discharge the duties for the performance of which they were created.

161 U.S. at 283; *accord Easton,* 188 U.S. at 231-34; *Farmers' & Mechanics',* 91 U.S. at 33-34. It is irrelevant whether the state law evolves from legislative or judicial action. *Van Reed,* 198 U.S. at 555.

The clear provisions of the National Bank Act, and not the intricacies and inconsistencies of the laws of fifty individual states, govern the method by which national banks are managed. The Act provides "a complete system for the management of national banks." *Cook County Nat'l Bank v. United States*, 107 U.S. 445, 448 (1883).

Sections 24 and 71 of the National Bank Act mandate that a national bank be managed solely by its board of directors. 12 U.S.C.A. §§ 24, 71 (West Supp. 1987). The bank's directors may delegate to subordinates certain management functions. Under the Act, however, it is the board which bears ultimate legal responsibility for the bank's management. *See* 12 U.S.C.A. § 93(a) (West Supp. 1987) (holding each director liable to any person who has sustained damages as a result of the director's violation of the Act).

In *Briggs v. Spaulding*, 141 U.S. 132 (1891), this Court recognized the board's ultimate responsibility for the management of a national bank and stated:

> [W]e hold that directors must exercise ordinary care and prudence in the administration of the affairs of a bank, and that this includes something more than officiating as figure-heads. They are entitled under the law to commit the banking business, as defined, to their duly authorized officers, but this does not absolve them from the duty of reasonable supervision . . . .

Id. at 165.

The principle was recognized in *Gibbons v. Anderson*, 80 F. 345 (W.D. Mich. 1897), where the court explained:

> [C]ongress had some substantial purpose when, in addition to the provision for executive officers, it further provided for a board of directors to manage the bank and administer its affairs. . . . The idea is not to be tolerated that they serve as merely gilded ornaments . . . to enhance [the bank's] attractiveness, or that their reputations should be used as a lure to customers. What the public suppose, and have the right to suppose, is that those men have been selected by reason of their high character for integrity, their sound judgment, and their capacity for conducting the affairs of the bank safely and securely.

Id. at 350.

Thus, Congress has promulgated strict standards for membership on the board of a national bank. Every director must be a United States citizen. 12 U.S.C.A. § 72 (West Supp. 1987). Two-thirds of the board members must live within the state in which the national bank is located, or within 100 miles of its location. *Id.* Every director is required to own capital stock in the national bank "to induce him to be vigilant in protecting the bank's interests." *Cupo v. Community Nat'l Bank & Trust Co.*, 324 F. Supp. 1390, 1393 (E.D.N.Y. 1971) (interpreting 12 U.S.C. § 72). Each director must take an oath that he will diligently perform his duties, and that he possesses the qualifications essential for his position. 12 U.S.C.A. § 73 (West 1945).

The unambiguous provisions of the National Bank Act make clear that Miami National's directors, as a matter of law, were solely responsible for the bank's management. It was improper for the Eleventh Circuit to attempt to engraft an exception to the plain language of the Act, as this Court has recently recognized. *Langley v. FDIC*, 56 U.S.L.W. 4026, 4028 (U.S. Dec. 1, 1987). Conflicting state law may not be applied to affect the plain meaning of the statute. The unequivocal language of the National Bank Act controls, and any change in its import is purely a matter for Congress. *Mercantile Nat'l Bank v. Langdeau*, 371 U.S. 555, 563 (1963).

Ironically, while the Eleventh Circuit's decision purportedly relies upon principles of common law, its conclusion is untenable under the common law's basic tenets. It is axiomatic that wherever one may be vicariously liable for the acts of another, there exists a concomitant right to supervise and control the acts of that individual. *See, e.g., Nelson v. Shell Oil Co.*, 396 So. 2d 752 (Dist. Ct. App.), *petition for review denied*, 407 So. 2d 1104 (Fla. 1981); *Variety Children's Hosp., Inc. v. Perkins*, 382 So. 2d 331 (Fla. Dist. Ct. App. 1980). Citibank had no right to supervise or control Miami National's directors, and therefore cannot be vicariously liable for the directors' acts.[4] Moreover, because Citibank had no power to manage Miami National, it could not have delegated that responsibility to Miami National's directors. Elementary principles of agency law make clear that a principal cannot delegate to an agent authority to do that which the principal cannot do

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[4]Indeed, the Eleventh Circuit recognized that any agreement whereby Citibank was authorized or required to control Miami National would be illegal and void. A-32.

for himself. *See, e.g., Phillips Petroleum Co. v. Peterson*, 218 F.2d 926 (10th Cir. 1954), *cert. denied*, 349 U.S. 947 (1955); *Connecticut v. Tedesco*, 175 Conn. 279, 397 A.2d 1352 (1978); *J.H. Marshall & Assocs., Inc. v. Burleson*, 313 A.2d 587, 596-97 (D.C. 1973); *Boatright v. City of Jacksonville*, 334 So. 2d 339 (Fla. Dist. Ct. App. 1976); *In re Dean*, 167 Pa. Super. 92, 74 A.2d 538 (1950); *see generally* RESTATEMENT (SECOND) OF AGENCY § 7 comment a (1958) (there is no authority to enter legal relation sought to be created by an agent unless the principal had the capacity to enter the legal relation); 2A C.J.S. *Agency* § 144 (1972) ("an agent cannot do what the principal himself cannot honestly or lawfully have done"); 3 AM. JUR. 2D *Agency* § 2 (1962) ("The fundamental idea of agency has its conception in some thing lawful that a person can do and a delegation by such person to another of the power lawfully to do that thing").

The Eleventh Circuit's decision ignores the paramount authority of the National Bank Act. The opinion undercuts the Act's provisions relating to bank management, and leaves each state to determine who bears ultimate responsibility for the management of national banks within its borders. It would relegate the legal status of national bank directors to "figureheads" or "gilded ornaments." The opinion conflicts with the provisions of the National Bank Act and should not be allowed to stand.

II. THE ELEVENTH CIRCUIT HAS DECIDED AN IMPORTANT QUESTION REGARDING THE DUTIES OF A PLEDGEE OF COLLATERAL IN DIRECT CONFLICT WITH A DECISION OF THE FIFTH CIRCUIT.

The Eleventh Circuit's opinion directly conflicts with the only other decision of a court of appeals discussing the duty of a pledgee of stock to preserve its underlying value. The decision suggests that Citibank, as pledgee of the Miami National stock, could be held liable for a decline in the underlying value of the stock resulting from mismanagement by directors elected and re-elected by Citibank, even though there was no evidence or allegation that Citibank acted with the specific intent to depreciate the value of the stock collateral. The opinion suggests that Data Lease can recover upon its U.C.C. claims simply upon a showing that Citibank was negligent, and that its negligence contributed to a decline in the value of the collateral. A-27-29.

The decision directly conflicts with the Fifth Circuit's opinion in *Empire Life Insurance Co. of America v. Valdak Corp.*, 468 F.2d 330 (5th Cir. 1972), the very case upon which the Eleventh Circuit seeks to rely. *Empire* holds that a pledgee of stock, in control of the company represented by the stock, cannot be held liable for a decline in value of the stock held as collateral in the absence of a specific intent to depreciate the value of the stock with the dishonest purpose of acquiring the stock at forced sale. 468 F.2d at 335-36. Both decisions are of great import because they construe the duty owed by a pledgee, pursuant to U.C.C. § 9-207, a provision which has been adopted in 49 states and the District of Columbia.[5]

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[5]U.C.C. § 9-207 (1978) provides in part:

(1) a secured party must use reasonable care in the custody and preservation of collateral in his possession.

(footnote continued on next page)

Both the Eleventh Circuit and Fifth Circuit opinions quote and adopt the law as set out in *Ritchie v. McMullen*, 79 F. 522 (6th Cir.), *cert. denied*, 168 U.S. 710 (1897). Unlike in *Empire*, however, the Eleventh Circuit opinion omits and departs from the key language of *Ritchie* regarding the duty of care of a pledgee of stock in regard to the underlying value of the stock:

> [T]he fact that the pledgee of stock controls the company represented by the stock does not eliminate its duty not to deplete the collateral intentionally. The general rule [is that]:
>
> > The bailee owes a direct duty to the pledgor to be reasonably careful that no harm shall come through his custody to the subject-matter of the pledge . . . *It is true that the obligations of the pledgee of stock to the pledgor would not be violated by the pledgee if the stock held in pledge suffered a loss in value through negligence of the pledgee in acting as director of the company or through ill-advised or negligent voting of other stock owned by him. . . .* But, if such pledgee use his position as director and his vote as stockholder *intentionally to depreciate the stock of his pledgor held in pledge with the dishonest purpose of acquiring ownership of the stock at forced sale,*

It has been uniformly held that a secured party's duty is to exercise reasonable care in regard to the physical preservation of collateral in its possession. *See, e.g., Capos v. Mid-America Nat'l Bank*, 581 F.2d 676 (7th Cir. 1978). The Eleventh Circuit and Fifth Circuit decisions are the only two courts of appeals' decisions which construe the extent of any duty owned by a pledgee voting the pledged shares, or in control of the corporation whose shares were pledged.

> this is a direct injury done by him to his pledgor . . . .

Empire, 468 F.2d at 335-36 (quoting *Ritchie*, 79 F. at 533-34) (emphasis added).

Under *Empire*, neither mismanagement nor negligent voting by the pledgee in control of the corporation represented by the pledged stock gives rise to an action by the pledgor against the pledgee. Rather, *specific intent* to deplete the underlying value of the collateral, with a dishonest purpose of acquiring ownership, is essential to any such cause of action. *Accord FDIC v. Webb*, 464 F. Supp. 520, 526 (E.D. Tenn. 1978) (holding that a pledgor, seeking to recover under U.C.C. § 9-207 for a decline in the value of stock collateral, must show that the pledgee acted with the specific intent to depreciate the underlying value of the pledged stock).

The Eleventh Circuit reversed the summary judgment entered in Citibank's favor because it concluded there was evidence in the record tending to show that Citibank "installed[ed] and maintain[ed] incompetent individuals in positions of management at Miami National" or "blithely allowed these individuals to deplete the value of the pledged collateral". A-28-29. Under *Empire*, however, Data Lease has no claim against Citibank because specific intent is an essential element of Data Lease's claims.

The Eleventh Circuit's opinion not only creates a conflict between circuits, but will serve to discourage, if not eliminate, cooperation between secured lenders and troubled debtors. There has long been "a legitimate and customary practice of keeping an oversight by a creditor over the business, management, and operations of a debtor of doubtful sol-

vency." *Krivo Indus. Supply Co. v. National Distillers & Chem. Corp.*, 483 F.2d 1098, 1105 (5th Cir. 1973) (quoting *Chicago Mill & Lumber Co. v. Boatmen's Bank*, 234 F. 41, 46 (8th Cir. 1916)); *see also Ritchie*, 79 F. at 551. If liability is imposed upon a pledgee for mismanagement by a board of directors or for negligent voting, absent a showing of specific intent by the pledgee to depreciate the underlying value of the pledged stock, no secured lender will be inclined to assist a troubled debtor in a workout situation. Rather than risk exposure to such liability, in a business climate where difficult business decisions necessarily will be made, a lender will have little choice but to slam the door on the struggling borrower. Clearly, the Eleventh Circuit's decision should not be allowed to stand.

CONCLUSION

For the reasons stated herein, petitioner, Citibank, N.A., requests that a writ of certiorari be issued to review the opinion and judgment of the United States Court of Appeals for the Eleventh Circuit.

Respectfully submitted,

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